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SENATE REPUBLICAN POLICY COMMITTEE

Legislative Notice

No. 41 December 5, 2007

H.R. 3996 – Temporary Tax Relief Act of 2007

Calendar No. 487

H.R. 3996 was read twice and placed on the Senate calendar on November 14, 2007.

Noteworthy

- On December 4, 2007 the Senate began consideration of the motion to proceed to H.R. 3996, Temporary Tax Relief Act of 2007. Senator Reid subsequently filed cloture on the motion to proceed.

- The cloture vote on the motion to proceed is expected to occur sometime on Thursday, December 6, 2007.

- On November 15, 2007 Senator Reid sought unanimous consent to bring up H.R. 3996. The UC agreement allowed for two hours of debate and then a cloture vote on the bill. If cloture was invoked, then no amendments would have been allowed and a vote on H.R. 3996 would have ensued. However, if cloture was not invoked, there would have been two amendments offered: (1) a Lott amendment to repeal the AMT and provide extenders for one year, with no offsets; and (2) a Baucus amendment that provided for one year of AMT relief and two years of extenders. The AMT would be un-offset, but the extenders would be paid for (with a deferred compensation provision, changes to public traded partnerships (PTP), and net operating loss from two years to one year as revenue raisers). Each amendment would have required 60 votes.

- However, Senator McConnell objected and offered an alternative UC that would have preserved the minority's rights to offer amendments. Senator McConnell's UC contained a one year AMT fix and two years of extenders un-offset, but also contained the ability for each side to offer four amendments. The UC would have given the Democrats the ability to offer their offsets, while preserving the chance for Republicans to offer permanent tax relief of various 2001/2003 tax cuts, stronger AMT relief, etc. Neither UC was agreed to.

- By a nearly party-line vote of 216-193, the House passed H.R. 3996 on November 9, 2007. The vote fell short of the two-thirds necessary to override the threatened presidential veto (please see Administration Position on page 11).

History

At its inception in 1969, the individual Alternative Minimum Tax (AMT) was intended to address a report by the Treasury Department that 155 high-income Americans avoided paying any federal income taxes in 1966 through the aggressive use of tax deductions and other legal techniques for sheltering income.[1] Today, by threatening to capture as many as 25 million Americans under current law, the AMT has mutated into a middle-class tax burden.

Since its inception in 1969, more than 20 pieces of legislation have made changes to the AMT. The original AMT rate was 10 percent on amounts in excess of the then-exemption of $30,000. By 1990, the AMT rate had increased to 24 percent. Today, the top AMT rate is at 28 percent.

Today, the AMT represents an excessive tax burden for millions of Americans, and one that will grow exponentially if it remains unchecked. If further action is not taken, it is estimated that the AMT could claim 35 million families and individuals by the end of this decade.[2] That is a substantial reach from the 3.5 million filers that are estimated to be affected by the AMT in 2006.[3]

Since 2001, Congress has enacted a series of Alternative Minimum Tax (AMT)[4] relief bills to index the AMT exemptions for inflation, thereby ensuring that the AMT does not partially undo the 2001 tax relief.[5] Yet since 2001, the latest that Congress has gone without fixing the AMT for the current tax year is May 11. If Congress does not pass an AMT bill, it is estimated that 25 million taxpayers will be subject to the AMT, 21 million *more* than were hit with the AMT last year, at an average *tax increase* of $2,000.

[1] Statement of Eric Solomon, Assistant Secretary for Tax Policy, U.S. Department of the Treasury, Testimony Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, available at http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5588 (March 7, 2007).
[2] Senator Charles Grassley, *Cong. Rec.*, February 12, 2007.
[3] The large difference in taxpayers affected in 2006 versus 2007 is due to the "hold-harmless patch" that expired at the end of 2006.
[4] For a detailed explanation of the AMT, please see Senate Republican Policy Committee, *The Far-Reaching Tentacles of the Alternative Minimum Tax: A Glimpse at Past Legislation*, April 17, 2007.
[5] Julia A. Seymour, Business and Media Institute, *Media Amnesia Strikes on AMT Reform, AMT Mess: Media blame Bush tax cuts, not politicians who neglected to index the tax to inflation*, April 11, 2007.

By waiting until now to bring AMT relief to the floor, there is a risk that the return processing for the 25 million taxpayers potentially subject to the AMT will be delayed. In addition to those taxpayers, because of the special ordering rule that applies to a number of credits, an *additional* 25 million taxpayers will also be impacted by processing and return delays if a bill is not passed.[6]

H.R. 3996 as passed by the House is the current legislative vehicle that the Senate is considering, and this notice provides details on the House-passed language. However, it is expected that a UC agreement will be reached which will contain both Democrat and Republican amendments to replace the language of H.R. 3996 as passed by the House.

Bill Provisions

I. 2007 AMT RELIEF

Extension of AMT relief for 2007. The bill extends for one year AMT relief for nonrefundable personal credits and increases the AMT exemption amount to $66,250 for joint filers and $44,350 for individuals. *This proposal is estimated to cost $50.59 billion over 10 years.*

II. ADDITIONAL INDIVIDUAL TAX RELIEF

Change in refundable child credit. The bill increases the eligibility for the refundable child tax credit in 2008. The child tax credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of approximately $11,000 as a result of inflation adjustments to the original floor of $10,000. The bill reduces this floor to $8,500 for 2008. *This proposal is estimated to cost $2.87 billion over 10 years.*

Additional standard deduction for real property taxes. The bill provides an additional standard deduction for state and local real property taxes paid or accrued by taxpayers who claim the regular standard deduction. The maximum amount that may be claimed under this provision is $700 for joint filers and $350 for individuals. This proposal applies only for 2008. *This proposal is estimated to cost $1.23 billion over 10 years.*

[6] http://www.treasury.gov/press/releases/reports/amtlettergrassley10232007.pdf.

III. ONE-YEAR EXTENDERS

Extenders Primarily Affecting Individuals

Extension of the deduction of state and local general sales taxes. The bill extends for one year the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction permitted for state and local income taxes. *This proposal is estimated to cost $2.34 billion over 10 years.*

Extension of above-the-line deduction for qualified tuition and related expenses. The bill extends the above-the-line tax deduction for qualified education expenses for one year. For tax year 2007, the maximum deduction was $4,000 for taxpayers with adjusted gross income (AGI) of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns). *This proposal is estimated to cost $2.47 billion over 10 years.*

Extension of special rules for regulated investment companies. The bill will for one year extend the tax treatment of interest-related dividends, short-term capital gain dividends, and other special rules applicable to foreign shareholders that invest in regulated investment companies. *This proposal is estimated to cost $77 million over 10 years.*

Extension of tax on failure to comply with mental health parity requirements applicable to group health plans. The bill extends for one year a $100 per day excise tax on group health plans that impose limits on mental health benefits that are not imposed on medical and surgical benefits. *This proposal is estimated to cost $25 million over 10 years.*

Extension of provision encouraging contributions of capital gain real property made for conservation purposes. The bill extends for one year the increased contribution limits and carryforward period for amounts in excess of these limits for contributions of appreciated real property (including partial interests in real property) for conservation purposes. *This proposal is estimated to cost $52 million over 10 years.*

Extension of tax-free distributions from individual retirement plans for charitable purposes. The bill extends for one year the provision that permits tax-free charitable contributions from an Individual Retirement Account (IRA) of up to $100,000 per taxpayer, per taxable year. *This proposal is estimated to cost $452 million over 10 years.*

Extension of above-the-line deduction for certain expenses of elementary and secondary school teachers. The bill extends for one year the $250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than non-athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services), other equipment, and supplementary materials used by the educator in the classroom for one year (i.e., to expenses paid or incurred in 2008). *This proposal is estimated to cost $204 million over 10 years.*

Extension of election to include combat pay in earned income for purposes of the earned income credit. The bill extends for one year the special rules that allow members of the armed services to include their combat pay in their earned income in order to qualify for the earned income tax credit. *This proposal is estimated to cost $19 million over 10 years.*

Extension of special rules for qualified mortgage bonds for veterans. The bill extends for one year the special rules that allow veterans to qualify for state-operated, tax-exempt mortgage revenue bond programs to provide lower-income individuals with access to mortgages with lower interest costs without regard to the first-time home buyer requirement. *This proposal is estimated to cost $159 million over 10 years.*

Extension of special rules for distributions from retirement plans to individuals called to active duty. The bill extends for one year special rules that permit active duty reservists to make penalty free withdrawals from retirement plans. *This proposal is estimated to cost $1 million over 10 years.*

Clarification of allowance for state legislators' expenses away from home. The bill clarifies that the legislature shall be considered to be in session on pro forma days for purposes of the allowance for state legislators' travel expenses away from home. *This proposal is estimated to cost $4 million over 10 years.*

Extenders Primarily Affecting Businesses

Extension of R&D credit. The bill extends the research and development credit for one year. *This proposal is estimated to cost $9 billion over 10 years.*

Extension of Indian employment credit. The bill extends for one year the business tax credit for employers of qualified employees who work and live on or near an Indian reservation. The credit is for wages and health insurance costs paid to qualified employees (up to $20,000) in the current year over the amount paid in 1993. Wages for which the work opportunity tax credit is available are not qualified wages for the Indian employment tax credit. *This proposal is estimated to cost $59 million over 10 years.*

Extension of new markets tax credit. The bill extends for one year (through the end of 2009) the new markets tax credit, permitting a $3.5 billion maximum annual amount of qualified equity investments. *This proposal is estimated to cost $1.32 billion over 10 years.*

Extension of railroad track maintenance credit. The bill extends for one year the railroad track maintenance credit. The railroad track maintenance credit provides Class II and Class III railroads (e.g., short-line railroads) with a tax credit equal to 50 percent of gross expenditures for maintaining railroad tracks that they own or lease. *This proposal is estimated to cost $165 million over 10 years.*

Extension of 15-year straight-line cost recovery for qualified leasehold improvements and qualified restaurant improvements. The bill extends for one year the special 15-year cost recovery period for certain leasehold and qualified restaurant improvements. Absent an extension of this provision, the cost recovery period for these facilities would be 39 years. *This proposal is estimated to cost $3.47 billion over 10 years.*

Extension of 7-year straight-line cost recovery period for motorsports entertainment complexes. The bill extends for one year the special 7-year cost recovery period for property used for land improvement and support facilities at motorsports entertainment complexes. Absent an extension of this provision, the cost recovery period for these facilities would be 15 years. *This proposal is estimated to cost $27 million over 10 years.*

Extension of accelerated depreciation for business property on an Indian reservation. The bill extends for one year the placed-in-service date for the special depreciation recovery period for qualified Indian reservation property. In general, qualified Indian reservation property is property used predominantly in the active conduct of a trade or business within an Indian reservation, which is not used outside the reservation on a regular basis and was not acquired from a related person. *This proposal is estimated to cost $148 million over 10 years.*

Extension of expensing of "brownfields" environmental remediation costs. The bill extends for one year the provision that allows for the expensing of costs associated with cleaning up hazardous ("brownfield") sites. *This proposal is estimated to cost $192 million over 10 years.*

Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico. The bill extends for one year the provision extending the section 199 domestic production activities deduction to activities in Puerto Rico. *This proposal is estimated to cost $116 million over 10 years.*

Extension of special tax treatment of certain payments to controlling exempt organizations. The bill extends for one year the special rules for interest, rents, royalties and annuities received by a tax exempt entity from a controlled entity. *This proposal is estimated to cost $23 million over 10 years.*

Reauthorization of qualified zone academy bonds (QZABs). The bill allows an additional $400,000,000 of QZAB issuing authority to state and local governments, which can be used to finance renovations, purchase equipment, develop course material, and train teachers and personnel at a qualified zone academy. In general, a qualified zone academy is any public school (or academic program within a public school) below college level that is located in an empowerment zone or enterprise community and is designed to cooperate with businesses to enhance the academic curriculum and increase graduation and employment rates. QZABs are a form of tax credit bonds which offer the holder a federal tax credit instead of interest. *This proposal is estimated to cost $165 million over 10 years.*

Extension of tax incentives for investment in the District of Columbia. The bill extends the designation of certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone. Businesses and individual residents within this enterprise zone are eligible for special tax incentives. The bill also extends for one year the $5,000 first-time homebuyer credit for the District of Columbia. *This proposal is estimated to cost $158 million over 10 years.*

Extension of American Samoa economic development credit. The bill extends for one year the American Samoa economic development credit. In general, this credit provides certain domestic corporations operating in American Samoa a possessions tax credit to offset their U.S. tax liability on income earned in American Samoa from active business operations, sales of assets used in a business, or certain investments in American Samoa. *This proposal is estimated to cost $16 million over 10 years.*

Extension of enhanced charitable deduction for contributions of food inventory. The bill extends for one year the provision allowing businesses to claim an enhanced deduction for the contribution of food inventory. *This proposal is estimated to cost $72 million over 10 years.*

Enhanced charitable deduction for contributions of book inventories to public schools. The bill extends for one year the provision allowing C corporations to claim an enhanced deduction for contributions of book inventory to public schools (kindergarten through grade 12). *This proposal is estimated to cost $31 million over 10 years.*

Extension of enhanced deduction for corporate contributions of computer equipment for educational purposes. The bill extends for one year a provision that encourages businesses to contribute computer equipment and software to elementary, secondary, and post-secondary schools by allowing an enhanced deduction for such contributions. *This proposal is estimated to cost $218 million over 10 years.*

Extension of special rule for S corporations making charitable contributions of property. The bill extends for one year the provision allowing S corporation shareholders to take into account their pro rata share of charitable deductions even if such deductions would exceed such shareholder's adjusted basis in the S corporation. The bill also makes a technical correction clarifying the application of this provision. *This proposal is estimated to cost $54 million over 10 years.*

Extension of work opportunity tax credit for Hurricane Katrina employees. The bill extends for one year the provision that expired in August of 2007 which allowed employers to claim the work opportunity tax credit for hiring employees who were affected by Hurricane Katrina. *This proposal is estimated to cost $21 million over 10 years.*

Other Extenders

Extension of disclosures of certain tax return information. The bill extends for one year the authority for combined employment tax reporting and the current-law authority to disclose return information for purposes of the income-contingent loan repayment program and for purposes of coordination with the Department of Veterans Affairs. The bill also extends for one year the present-law terrorist activity disclosure provisions. *These proposals are not estimated to have any revenue effect.*

Extension of authority for undercover operations. The bill extends for one year the authorization for the IRS to engage in certain activities related to undercover operations, such as purchasing property, organizing business entities, and using the proceeds from an undercover operation to pay additional expenses incurred in the undercover operation. *This proposal is estimated to have a negligible revenue effect.*

Extension of temporary increase in limit on cover over of rum excise tax revenues to Puerto Rico and the Virgin islands. The bill extends for one year the provision providing for payment of $13.25 per gallon to cover over a $13.50 per proof gallon excise tax on distilled spirits produced in or imported into the United States. *This proposal is estimated to cost $93 million over 10 years.*

IV. MORTGAGE FORGIVENESS DEBT RELIEF

Permanent exclusion from gross income of discharged home mortgage indebtedness. The bill amends current law, which requires taxpayers to include discharges of mortgage indebtedness as income and to pay tax on this income. The bill provides a permanent exclusion for discharges of up to two million dollars of indebtedness (on or after January 1, 2007) which is secured by a principal residence and which is incurred in the acquisition, construction, or substantial improvement of the principal residence. Instead of including this amount as income, the basis of the individual's principal residence will be reduced by the amount excluded from income under this bill. *This proposal is estimated to cost approximately $1.34 billion over 10 years.*

Long-term extension of the deduction for mortgage insurance. The bill extends the deduction for mortgage insurance for seven years (through the end of 2014). Current law limits the deduction for mortgage insurance to payments (including Veterans Administration, Rural Housing Administration, and Federal Housing Administration insurance premiums) made prior to the end of 2007. The bill provides that payments will qualify for this deduction whenever they are paid so long as the contract is entered into after 2006 and before 2015. *This proposal is estimated to cost $570 million over the next 10 years.*

Modification of the qualification tests for cooperative housing corporations. The bill modifies the requirements for qualifying for the special rules available to cooperative housing corporations. Under current law, a cooperative housing corporation must meet several requirements, including a requirement that 80 percent or more of the cooperative housing corporation is earned from the corporation's tenant-stockholders. The bill provides two alternatives to this 80-percent rule (one based on square footage and another based on cooperative expenditures). These two alternatives will make it easier to qualify as a cooperative housing corporation. *This proposal is estimated to cost $21 million over 10 years.*

Modification of exclusion of gain on sale of a principal residence. The bill amends the current law exclusion of up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. Under current law, the sale of a home will qualify for this exclusion if the home is a taxpayer's principal residence for at least two of the five years ending on the sale or exchange. This exclusion applies even if the home was initially purchased as a second home. Under the bill, if a taxpayer moves their principal residence to a second home, the taxpayer will only be able to utilize this exclusion to the extent that it relates to the period of time when the home was first used as a principal residence. The bill grandfathers use before 2008. *This proposal is estimated to raise $1.99 billion over 10 years.*

V. ADMINISTRATIVE PROVISIONS

Repeal of IRS authority to enter into private debt collection contracts. The provision repeals the IRS's authority to enter into, renew, or extend contracts with private companies to collect federal income taxes. *This provision is estimated to cost $1.05 billion over 10 years.*

Delay application of withholding requirement on certain governmental payments for goods and services. For payments made after December 31, 2010, the Internal Revenue Code requires withholding at a 3-percent rate on certain payments to persons providing property or services made by federal, state, and local governments. The withholding is required regardless of whether the government entity making the payment is the recipient of the property or services (those with less than $100 million in annual expenditures for property or services are exempt). Numerous government entities and taxpayers have raised concerns about the application of this provision. The bill delays for one year (through December 31, 2011) the application of the three percent withholding requirement on government payments for goods and services in order to provide time for the Treasury Department to study the impact of this provision on government entities and other taxpayers. *This provision is estimated to cost $44 million over 10 years.*

Clarification of entitlement of U.S. Virgin Islands residents to taxpayer statute of limitations protections. The provision extends to residents of the U.S. Virgin Islands (USVI) the same administrative and procedural protections that are available to U.S. taxpayers, including a three-year statute of limitations on collections. As a result of a misapplication of present law by the IRS, U.S. citizens who claim to be bona fide USVI residents and who file USVI income tax returns are not allowed to claim the statute of limitations protection that is available to other U.S. citizens who file income tax returns. *This provision is estimated to cost $38 million over 10 years.*

Revision of tax rules on expatriation. U.S. citizens and long-term U.S. residents are subject to tax on their worldwide income. Taxpayers can avoid taxes by renouncing their U.S. citizenship or terminating their residence. This provision tightens current law rules to ensure that certain high net-worth taxpayers cannot renounce their U.S. citizenship or terminate their U.S. residence in order to avoid U.S. taxes. Under this provision, high net-worth individuals will be treated as if they sold all of their property for its fair market value on the day before such individual expatriates or terminates their residency. Gain will be recognized to the extent that the aggregate gain recognized exceeds $600,000 (which will be adjusted for cost of living in the future). *This provision is estimated to raise $730 million over 10 years.*

Repeal of suspension on certain penalties and interest. Generally, the accrual of interest and penalties is suspended starting 36 months after the filing of a tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. The provision repeals the suspension of interest and penalties on certain tax deficiencies where the IRS has notified a taxpayer after 36 months, allowing the IRS to fully investigate cases of taxpayer underpayment and to increase compliance with tax laws. *This provision is estimated to raise $128 million over 10 years.*

Clarification of unused merchandise drawback. The bill clarifies that wine of the same color shall be deemed to be commercially interchangeable for purposes of duty drawback. *This proposal has not yet been scored.*

VI. REVENUE PROVISIONS

Current inclusion of deferred compensation paid by certain tax indifferent parties. The bill taxes individuals on a current basis if such individuals receive deferred compensation from a tax indifferent party. Current law generally allows executives and other employees to defer paying tax on compensation until the compensation is paid. This deferral is made possible by rules that require the corporation paying the deferred compensation to defer the deduction that relates to this compensation until the compensation is paid. Matching the timing of the deduction with the income inclusion ensures that the executive is not able to achieve the tax benefits of deferred compensation at the expense of the Treasury. Instead, the corporation paying the compensation bears the expense of paying deferred compensation as a result of the deferred deduction. Where an individual is paid deferred compensation by a tax indifferent party, there is no offsetting deduction that can be deferred. As a result, individuals receiving deferred compensation from a tax indifferent party are able to achieve the tax benefits of deferred compensation at the expense of the Treasury. *This proposal is estimated to raise $23.85 billion over 10 years.*

Taxation of carried interest as ordinary income. The bill prevents investment fund managers from paying taxes at capital gains rates on investment management services income received as carried interest in an investment fund. The bill requires such managers to treat carried interest as ordinary income received in exchange for the performance of services to the extent that carried interest does not reflect a reasonable return on invested capital. The bill continues to tax carried interest at capital gain tax rates to the extent that carried interest reflects a reasonable return on invested capital. *This proposal is estimated to raise $25.62 billion over 10 years.*

Modification of unrelated business income tax rules for certain investment partnerships. The bill allows pension plans, universities and other tax-exempt entities to directly invest in hedge funds and other investment funds without incurring unrelated business income tax (UBIT). *This proposal is estimated to cost $1.34 billion over 10 years.*

Treatment of certain gain on sales between related persons as ordinary income as a result of tax sharing agreements. Under current law, if a taxpayer sells depreciable property to a related person, any gain recognized on that transfer will be ordinary income. The bill treats taxpayers as being related if there is an agreement (e.g., a tax sharing agreement) between the parties that provides for the payment to the transferor of any amount which is determined by reference to the tax benefit realized by the transferee as a result of depreciating the property transferred. *This proposal is estimated to raise $135 million over 10 years.*

Delay implementation of worldwide allocation of interest. In 2004, Congress provided taxpayers with an election to take advantage of a liberalized rule for allocating interest expense between U.S. sources and foreign sources for purposes of determining a taxpayer's foreign tax credit limitation. Although enacted in 2004, this election is not available to taxpayers until taxable years beginning after 2008. The bill delays the phase-in of this new liberalized rule for eight years (for taxable years beginning after 2017). *This proposal is estimated to raise $24.90 billion over 10 years.*

Basis reporting by brokers on sales of stock. The bill creates mandatory cost basis reporting by brokers for transactions involving publicly traded securities. Covered securities are generally stock, debt, commodities, derivatives and other items as specified by the Treasury Secretary, which are acquired in the account or transferred to the account managed by the broker. The provision applies to stock acquired after January 1, 2009 and after January 1, 2011 for all other instruments. *This proposal is estimated to raise $3.37 billion over 10 year.*

Administration Position

The Statement of Administration Policy released on November 8, 2007 stated that if H.R. 3996 was presented in its present form to the President, his senior advisors would recommend he veto it. For the complete Statement of Administration Policy, please see http://www.whitehouse.gov/omb/legislative/sap/110-1/hr3996sap-r.pdf.

Cost

The Congressional Budget Office (CBO) estimates that enacting H.R. 3996 would reduce revenues by $372 million over the 2008-2012 period, and reduce revenues by $390 million over the 2008-2017 period.

Possible Amendments

It is expected that if the Senate takes up the bill, it will not vote on H.R. 3996 in its current form; rather, there will be numerous amendments that will replace the current language. There will most likely be an amendment from the Democratic side that will grant one year AMT relief with two years of extenders, with only the extenders being offset (similar to the Baucus amendment that was offered in the November 15, 2007 UC). The Republican side may offer several amendments similar to what Senator McConnell offered in a UC agreement on December 4, 2007: (1) an unoffset AMT extension and an unoffset extenders package; (2) a Sessions amendment related to AMT and exemptions; (3) an Ensign amendment that repeals the AMT and extends other expiring provisions; and (4) a DeMint amendment which relates to AMT and flat tax.